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Disclosure and Confidentiality Requirements of Corporate Pension Plan Actuaries

Theodore Konshak*

Abstract

Corporate pension plan actuaries are subject to the standards of the Joint Board for the Enrollment of Actuaries. The Joint Board is empowered to establish such standards under the provisions of the Employee Retirement Income Security Act of 1974, a federal law. In consideration of these statutory standards, this article will discuss whether standards published by professional actuarial organizations have any applicability. The contrast between the disclosure requirements of federal law and the confidentiality standards of the Society of Actuaries will be highlighted.

Key words and phrases: *ERISA, actuarial standards, fiduciaries, enrolled actuary, plan auditor*

1 Introduction

Defined benefit pension plans promise to pay a monthly income to each participant for the remainder of the participant's lifetime or for the lifetimes of both the participant and his or her spouse. Money is deposited into a trust fund, is invested by the pension plan trustees, and is periodically withdrawn by the plan administrator to pay retirees their monthly benefits. In the United States, the minimum amount to be deposited into the trust fund is based on an annual actuarial valuation performed by an enrolled actuary under the terms of the 1974 Employee Retirement Income Security Act (ERISA).

In addition to providing actuarial services under ERISA, actuarial service providers also can earn income by providing an employer with

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a wide variety of services including, but not limited to, recordkeeping services for defined contribution pension plans and consulting services on the legal requirements of the pension plan.

This paper reviews the required disclosures of the enrolled actuary under ERISA and the confidentiality provisions of the Professional Code of Conduct of the Society of Actuaries to determine if the statutory standards of ERISA are being subverted, inadvertently or otherwise, by these professional standards.

2 Enrolled Actuaries and Plan Auditors

Corporate pension plans are classified into two general types based on whether the provisions of the plan define the deposits or the withdrawals:

- In a defined benefit plan, the plan provisions define a series of monthly withdrawals payable during the lifetime of the participant. The minimum deposit under federal law is determined by an actuarial valuation performed by an enrolled actuary.
- In a defined contribution plan, the plan provisions define the deposits that can and will be made. Withdrawals are these deposits and the investment earnings on these deposits. Defined contribution plans do not require the services of an enrolled actuary because the deposit is specified by the terms of the plan.

A pension plan auditor examines the financial statements of the pension plan. In addition to determining whether the money is actually there, the pension plan auditor reviews the statement of where the money has gone. Both defined benefit and defined contribution pension plans with at least 100 participants require the services of an auditor.

Under ERISA administrators of pension plans must engage both an enrolled actuary and pension plan auditor on the behalf of all plan participants. For enrolled actuaries, this is the actual language of Section 103(a)(4)(A) of ERISA.

Engagement on the behalf of all plan participants is a legal requirement to ensure the impartiality of actuarial determinations and the integrity of pension plan audits. The accuracy of audited pension records should not reflect the effort an employer is willing to exert. The minimum deposit required under federal law should not reflect the amount the employer currently is willing to contribute. Impartiality of actuarial determinations and integrity of pension plan audits are duties and obligations of the enrolled actuary and pension plan auditor.

The administrators of pension plans who hire the enrolled actuary and pension plan auditors are fiduciaries under Section 21(A) of ERISA. This means plan administrators must discharge their duties solely in the interest of plan participants (Section 404(a)(1) of ERISA). Fiduciaries are the responsible parties and may be held legally liable for any misconduct.

Enrolled actuaries are accredited and regulated by the Joint Board for the Enrollment of Actuaries, a federal board consisting of three members appointed by the Secretary of the Treasury and two members appointed by the Secretary of Labor. The Joint Board is administered by an executive director appointed by the Secretary of the Treasury.

Section 3042 of ERISA describes the enrollment of actuaries by the Joint Board:

The Joint Board shall, by regulations, establish reasonable standards and qualifications for persons performing actuarial services with respect to plans to which this Act applies and, upon application by any individual, shall enroll such individual if the Joint Board finds that such individual satisfies such standards and qualifications . . . The Joint Board may, after notice and an opportunity for a hearing, suspend or terminate the enrollment of an individual under this section if the Joint Board finds that such individual—(1) has failed to discharge his duties under this Act, or (2) does not satisfy the requirements for enrollment as in effect at the time of his enrollment.

The Standards of Performance for Enrolled Actuaries were published by the Joint Board under Title 20, Chapter VIII, Part 901, Subpart C of the Code of Federal Regulations.

The executive director of the Joint Board maintains a roster of all persons whose enrollment to perform actuarial services under ERISA has been suspended or terminated. This roster contains the names of only two suspended enrolled actuaries.

To date the Joint Board has devoted most of its limited resources to the accreditation of enrolled actuaries through examinations and continuing education. Regulation of enrolled actuaries through its standards of performance has not been a priority. These statutory standards of performance may be expanded and be more strictly enforced if the composition of the Joint Board is changed to include representatives of the Pension Benefit Guaranty Corporation (PBGC).¹

¹The Pension Benefit Guaranty Corporation (PBGC) is the federal agency that insures the payment of benefits from failed pension plans. As in other insolvency insurance

A representative of the PBGC presently can participate in discussions of the Joint Board, but cannot vote on any issues. As the minutes of the March 15, 1995 meeting of the Joint Board indicate, the PBGC has attempted in the past to obtain voting representation on the Joint Board. Unreasonable actuarial determinations of the variable rate premium paid by corporate sponsors to the PBGC could intensify their efforts to obtain such representation.

3 Actuarial Codes of Conduct

3.1 Professional

Actuarial organizations publish codes of professional conduct to govern the relationship between consulting actuary and client/employer. The professional codes of conduct of virtually every actuarial organization in the United States are identical to the Code of the Society of Actuaries. Uniformity is necessary because the Actuarial Board for Counseling and Discipline (ABCD) enforces these actuarial codes of conduct for the professional actuarial organizations sponsoring its activities.

The following is from Precept 10 and Annotation 10-1, respectively, of the Code of Professional Conduct of the Society of Actuaries (1996)²:

An actuary shall not disclose to another party any confidential information obtained through professional services performed for a principal (i.e., client or employer) unless authorized to do so by the client or employer or required to do so by law. "Confidential information" refers to information not in the public domain of which the actuary becomes aware in conjunction with the rendering of professional services to a principal. It may include . . . information which the actuary has reason to believe that the principal would not wish to be divulged.

3.2 Criminal

Under Title I, Section 103(d) of ERISA the results of the annual actuarial valuation are to be disclosed on an actuarial statement prepared by

pools sponsored by the federal government (e.g., the FDIC for banks and the FSLIC for savings and loan associations), the PBGC is financed by premiums paid by the corporate sponsors of the defined benefit pension plans covered under the program.

²Society of Actuaries. *1996 Society of Actuaries Yearbook*. Schaumburg, Ill.: Society of Actuaries, 1996.

the enrolled actuary (i.e., the Schedule B prepared by the enrolled actuary and attached to the annual Form 5500 filed by the plan administrator). Section 103(d) of ERISA also requires the disclosure of information including, but not limited to, a statement of actuarial assumptions and methods used to determine costs and justifications for any change in those actuarial assumptions or methods. Section 103(d)(13) of ERISA requires disclosure of “such other information as may be necessary to fully and fairly disclose the actuarial position of the plan.”

Section 1027 of the Criminal Codes states:

Whoever, in any document required by Title I of the Employee Retirement Income Security Act of 1974 (as amended from time to time) to be published, . . . knowingly conceals, covers up, or fails to disclose any fact the disclosure of which is required by such title or is necessary to verify, explain, clarify, or check the accuracy and completeness any report required by such title to be published . . . shall be fined not more than \$10,000, or imprisoned not more than five years, or both.

ERISA created an enrolled actuary engaged on behalf of all plan participants, imposed duties and obligations under ERISA on that enrolled actuary, and subjected him or her to the standards of the Joint Board for the Enrollment of Actuaries. Professional actuarial organizations also have standards governing the relationship between consulting actuary and client/employer. Confidentiality and full disclosure are examples of when the duties of the enrolled actuary are diametrically opposed to the standards of professional actuarial organizations.

3.3 Contrast to Pension Plan Auditor

Under the terms of Section 103(a)(3)(A) of ERISA the pension plan auditor examines the books and records of the pension plan under generally accepted auditing standards. In contrast, actuarial services are not performed under ERISA according to generally accepted actuarial standards. That term does not appear and would not have to appear in ERISA because the Joint Board for the Enrollment of Actuaries establishes the standards for enrolled actuaries.

The statement preceding the enrolled actuary's signature on Schedule B (Form 5500) makes no reference to generally accepted actuarial standards:

To the best of my knowledge, the information supplied in this schedule and on the accompanying statements, if any, is

complete and accurate and, in my opinion, each assumption used in combination represents my best estimate of anticipated experience under the plan. Furthermore, in the case of a plan other than a multiemployer plan, each assumption used is (a) reasonable (taking into account the experience of the plan and reasonable expectations) or (b) would, in the aggregate, result in a total contribution equivalent to that which would be determined if each such assumption were reasonable. In the case of a multiemployer plan, the assumptions used, in the aggregate, are reasonable (taking into account the experience of the plan and reasonable expectations).

Because actuarial determinations under ERISA are calculated according to standards established by the Joint Board for the Enrollment of Actuaries and not according to the standards of the actuarial profession, enrolled actuaries have no legal basis for citing any actuarial standard under the Code of Professional Conduct of the Society of Actuaries or any other actuarial organization. Auditing standards have legal recognition and standing under ERISA. The standards of professional actuarial organizations do not enjoy such recognition or standing.

3.4 Consequences of Suspension

One of the two suspended enrolled actuaries on the Joint Board roster is currently a trustee of a major actuarial foundation. The other continues to be a consulting pension actuary with a major employee benefits consulting firm and was the discussion leader at a workshop on public employee retirement systems at an annual enrolled actuaries meeting.³

At least in these two cases employment and status within the actuarial profession were not adversely impacted by suspension as an enrolled actuary. Legally the statutory standards of the Joint Board take precedence. In practice, does the lack of detrimental consequences for suspension as an enrolled actuary suggest minimal respect for the statutory standards of the Joint Board?

³Under the separation of powers doctrine, pension plans sponsored by state and local governments (i.e., public employee retirement plans) are exempted from the requirements of ERISA, a federal law, and their actuaries therefore do not have to be enrolled by the Joint Board.

Table 1
Changes in Actuarial Assumptions and Techniques

Type of Change	Number of Changes		
	Actual	Reported	Justified
Investment Return	8	5	2
Retirement Ages	4	2	1
Salary Increase	7	5	3
Terminations of Employment	7	2	2
Disabilities	2	1	0
Deaths	7	3	2
Payment of Plan Expenses	3	2	1
Funding Method Changes	14	13	1
Other	5	3	1
Total	57	36	13

4 Changes in Actuarial Assumptions & Techniques

4.1 The Study

Section 103(d) of ERISA and the instructions for completing Schedule B require the enrolled actuary to attach a statement of actuarial assumptions and techniques, a statement of the changes in actuarial assumptions and techniques, and a statement justifying those changes in actuarial assumptions and techniques. In a study of a sample of 20 pension plans that changed actuarial consulting firms, Konshak (1995)⁴ tabulated the number of actual, reported, and justified changes. These results are reported in Table 1. The asset values of the pension plans sampled range from \$207 million to \$16 million.

The actual changes in presented in Table 1 are obtained by comparing the statement of actuarial assumptions and techniques attached to the 1993 Schedule B to the similar statement attached in the 1992 Schedule B. Reported changes and justifications are tabulated from the 1993 attachments to Schedule B.

⁴Konshak, T. *Financial Effect of Actuarial Marketing Practices on the Solvency of Corporate Pension Plans: First Annual Study*. (A Research Report). Green Bay, Wis.: Negotiated Pension Plans, Ltd., 1995. A copy of this study can be obtained by writing directly to the author.

According to the analysis of 1993 and 1992 Schedule B attachments there were 57 changes in actuarial assumptions and techniques required to be reported and justified. Thirty-six of these changes were reported by the enrolled actuary on the current Schedule B attachment. Only 13 of the reported changes (12 changes in actuarial assumptions and one change in actuarial techniques) were justified by the enrolled actuary.

The practice of failing to disclose and justify changes in actuarial assumptions and techniques is either incompetence (enrolled actuaries certify to their familiarity with those portions of ERISA relating directly or indirectly to the responsibilities of an enrolled actuary on the Form 5434-A application for their triennial renewal of enrollment) or a knowledgeable concealment (corporate pension plan actuaries choose not to be governed by these provisions of ERISA). In any event, these individuals have failed to discharge their duties under the terms of ERISA.

4.2 An Example of a Justification

Although most of the justifications for changes in actuarial assumptions and techniques are not immediately verifiable, one justification from the Konshak study will be analyzed for reasonableness.

The assumed rate of future employment terminations was changed and justified by the enrolled actuary solely on the basis of prior plan experience: "The ultimate withdrawal rates were increased by a factor of 10 in order to better reflect actual plan experience." Enrolled actuaries who change actuarial assumptions and techniques in this study, however, normally would not have a personal and intimate knowledge of the prior plan experience. Pension plans in this example changed actuarial service providers.

The prior experience of the pension plan can be established by studying individual participant records if available from the prior enrolled actuary or corporate sponsor. Corporate sponsors, however, generally are unwilling to incur the substantial expense of performing such a study. The corporate sponsor in this case changed actuarial service providers to reduce its actuarial expenses and provided that as the reason for the change in enrolled actuary on the Schedule C (Form 5500) filed with the federal government: "Change due to receipt of more competitive bid from another actuary firm."

The change in the assumed rate of future terminations of employment was the only change in actuarial assumptions or techniques made by the new enrolled actuary, and this assumption change significantly decreased the minimum deposit payable under federal law. The expla-

nation for the change in enrolled actuary implies an experience study would not have been performed due to cost considerations and suggests another reason for the change in withdrawal rates: cutting costs for the corporate sponsor.

5 Resolution of Conflicting Values

Pension actuaries believe they can balance their roles as consultants to the employer (subject to the standards of the Code of Professional Conduct) with their duties and obligations as enrolled actuaries (subject to the requirements of ERISA and the standards of the Joint Board). Technically, the previously quoted section of the Society of Actuaries' Code of Professional Conduct relating to confidentiality does not conflict with the statutory requirements of ERISA: "An actuary shall not disclose to another party any confidential information obtained through professional services . . . unless . . . required to do so by law." A written disclaimer in the Code, however, can not erase a sentiment to maintain confidentiality through superficial rather than full disclosure.

The justification quoted in the previous section for the change in withdrawal rates could have been subjected to a peer review. If an experience study had been performed, a peer reviewer could have avoided the aforementioned challenge to the reasonableness of this justification by suggesting its inclusion: "Based on the results of an experience study, the ultimate withdrawal rates were increased by a factor of 10 in order to better reflect actual plan experience." None of the assumption changes made by the other enrolled actuaries included in my study were justified in terms of an experience study.

If an experience study had not been performed, a peer reviewer could make two criticisms. First, the rate of increase, "by a factor of 10," will draw the attention of the reader and should be eliminated. Second, even though the statement preceding the enrolled actuary's signature on the Schedule B necessitates consideration of both prior and expected experience by requiring reasonable assumptions "taking into account the experience of the plan and reasonable expectations," this assumption change should have been justified solely in terms of the expected future experience of the plan. Drawing attention to the prior plan experience makes a regulatory request for data and a challenge based on that prior plan experience more likely. If the justification were changed according to these recommendations, it would be consistent with the justifications provided by the other enrolled actuaries reviewed by the

Konshak study: "The withdrawal rates were increased to better reflect the expected future experience of the plan."

Of the 12 actuarial assumption changes justified by the enrolled actuaries included in the Konshak study, nine were justified solely on the basis of the expected future experience of the plan. Two of the assumption changes were justified both in the terms of the prior and the expected future experience of the plan (consistent with the enrolled actuary's statement on the Schedule B). Only the justification being analyzed was justified solely in terms of prior plan experience. None of the enrolled actuaries supplied evidence or any specific information to support their assertions.

By failing to introduce the uncertainty involved in predicting the future experience of the plan, the justification analyzed in Section 4.2 above lacks the vagueness of the other justifications reviewed by the Konshak study and therefore could be subjected to a challenge on its reasonableness. By maximizing vagueness and minimizing specifics, the other justifications reflect a sentiment to conceal under the confidentiality provisions of the Code of Professional Conduct rather than a sentiment to disclose under the statutory requirements of ERISA.

6 Conclusions

The codes of conduct of professional actuarial organizations and their standards of actuarial practice are irrelevant for the enrolled actuary performing actuarial services under ERISA. Actuarial codes and standards can only confuse the issue and provide opportunities to subvert, inadvertently or otherwise, the intent of statutory standards. Giving any credibility to the confidentiality provisions of any professional actuarial code would be irresponsible and contrary to the disclosure requirement of federal law.

Enforcement from federal agencies is a reasonable and expected result for those pension actuaries who believe their professional codes of silence are above the law. This enforcement to date has been passive and lacking, but the Joint Board may actively search for enrolled actuaries failing to discharge their duties under ERISA when the PBGC has more influence with the Joint Board.